

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of)

McLEODUSA TELECOMMUNICATIONS)
SERVICES, Inc.)

CC Docket No. 98-84

Petition for Preemption of Nebraska Public)
Service Commission Decision Permitting)
Withdrawal of Centrex Plus Service by)
USWest Communications, Inc.)

REPLY COMMENTS OF THE
COMPETITION POLICY INSTITUTE

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July 27, 1998

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REPLY COMMENTS OF THE COMPETITION POLICY INSTITUTE

I. INTRODUCTION

The Competition Policy Institute ("CPI") hereby submits its reply comments in support of the Petition for Preemption, Declaratory Ruling, and Injunctive Relief ("Petition") filed by McLeodUSA Telecommunications Services, Inc. ("McLeodUSA") on June 2, 1998. CPI submits that the Nebraska Public Service Commission's ("Nebraska PSC") decision to allow USWest to withdrawal its provision of Centrex service in Nebraska harms consumers, prevents the growth of local telephone competition, and is unlawful under the Communications Act of 1934, as amended. While the Federal Communications Commission ("FCC" or "Commission") generally should not intrude on the jurisdiction of state regulatory agencies over local service offerings, the facts in this case are unusual. The FCC should take some action, working with the Nebraska PSC as much as possible, to require USWest to continue to make its Centrex service generally available to consumers and resellers.

II. USWEST'S WITHDRAWAL OF CENTREX SERVICE HAS CAUSED HARM TO CONSUMERS AND COMPETITION.

In 1996, CPI brought a similar issue to the attention of the FCC. In 1994, the Public Utilities Commission of Texas upheld a tariff provision of SBC Communications that imposed a "continuous property restriction" ("CPR") on resellers of Centrex service. The CPR essentially barred companies from reselling

SBC's Centrex service except to those customers in a single location. CPI petitioned the Commission to preempt the application of the CPR as a barrier to entry under section 253. The FCC agreed with CPI and other commenters and preempted the application of the CPR.¹ While SBC has filed a petition for reconsideration of that decision, the Commission has not ruled on this SBC petition and the preemption remains in effect.

USWest's withdrawal of Centrex service in Nebraska has an even more harmful effect on the development of competition in Nebraska than SBC's application of the CPR in Texas. Whereas the CPR effectively barred the resale of Centrex service to users situated in multiple locations, it at least permitted resale of Centrex to users in the same location. The withdrawal of Centrex in Nebraska, however, effectively prohibits *any* resale of Centrex service by *any* entity to *any* potential customer (except for those existing USWest customers who are "grandfathered"). As McLeodUSA, Frontier TeleManagement, Inc. ("FTI") and Advanced Telecommunications, Inc. ("ATI") explain, the withdrawal of Centrex service in Nebraska has effectively prevented them from offering service in Nebraska.²

¹ See, *Petitions for Declaratory Ruling and/or Preemption of Certain Provisions of the Texas Public Utility Regulatory Act of 1995*, CCB Pol 96-13, 96-14, 96-16, 96-19, Memorandum Opinion and Order, 13 FCC Rcd 3460 (1997) ("Texas Preemption Order").

² See, Petition, p. 2 ("Due solely to the withdrawal of Centrex from Nebraska, McLeodUSA does not today offer local service in that state, even though it does so in the surrounding states on all sides of Nebraska that are in USWest's region."); Comments of FTI and ATI (collectively, "Joint Filers"), p.2 ("The Nebraska PSC's decision to allow USWest to withdraw Centrex has substantially undermined the Joint Filers' ability to provide competitive telecommunications services in

CPI is especially concerned about the events in Nebraska because of its effect on the development of local competition. More than two years after passage of the Telecommunications Act of 1996 ("1996 Act"), competition for local service has been slow to develop. The Commission has already expressed concern about the slow pace of competition and has requested comment on actions that it should take to stimulate greater local competition.³ This Petition presents the Commission with a clear opportunity to take decisive action in favor of consumers and competition.

In its opposition to SBC's petition for reconsideration, CPI raised two arguments that are equally apt here: **First, Centrex resale could provide the critical path toward the competition for small business and residential consumers that policy-makers and the public are seeking.** The availability of Centrex allows resellers to aggregate traffic from small business and residential users and provide them with lower-priced local exchange services than they would otherwise receive from the incumbent local exchange carrier. **Second, competition from Centrex resale will give the local exchange carriers stronger incentives to reduce access charges to efficient economic cost levels, thereby giving effect to the Commission's market-based approach toward access charge reform.** If the Commission's "market-based" approach toward access charge reform is to work at all, then competitors must be provided

Nebraska by withdrawing the platform each Joint Filer could use to provide service to its customers.")

³ Common Carrier Bureau Seeks Recommendations on Commission Actions Critical to the Promotion of Efficient Local Exchange Competition, CCB Pol 97-9, DA 97-1519, released July 18, 1997.

with alternative means of access to the customer. Centrex resale allows consumers and carriers to benefit from lower access charges and encourages the local exchange carriers to reduce their access charges to economic cost.

In short, this proceeding provides the perfect opportunity for the Commission to follow through on its oft-stated desire to help consumers and stimulate local competition.

Further, there appears to be little risk to granting the Petition. USWest does not, for instance, allege that the withdrawal of Centrex is necessary to support universal service. Nor does it allege that the provision of Centrex causes any harm to consumers whatsoever.

Finally, the Commission should be particularly attuned to USWest's motives in withdrawing Centrex service. As McLeodUSA notes, USWest proposed to withdraw its Centrex service offering just days before final passage of the 1996 Act. According to USWest, one of its reasons for withdrawing Centrex was that Centrex resale was becoming "an arbitrage vehicle" (USWest Comments, p. 4) In other words, USWest withdrew its Centrex service offering, at least in part, to avoid facing the competition from Centrex resellers that was sure to develop after passage of the 1996 Act. The Commission should simply not countenance efforts by any incumbent local exchange carrier to withdraw service as a means of delaying local competition.

While CPI does not generally endorse FCC actions that intrude on the decisions of state regulatory commissions, the circumstances in this case are unique

and are sufficient to justify FCC action. These circumstances include:

1. the great harm to competition that has resulted from the withdrawal of Centrex service,
2. the anticompetitive incentives of the local carrier,
3. the fact that USWest provided this service for many years and continues to make Centrex service available to existing customers, and
4. the potential benefits to consumers of lower prices and greater competition,

For all these reasons, the Commission should find a way to require USWest to continue to make its still-existing Centrex service generally available to all consumers and Centrex resellers.

III. THE COMMENTERS FAIL TO JUSTIFY USWEST'S WITHDRAWAL OF CENTREX SERVICE.

USWest's only arguments against granting the Petition are 1) that McLeodUSA has not presented sufficient facts to warrant preemption; 2) that, should the Commission order USWest to provide a service, it might "cross the line and result in actual governmental expropriation of the property of the affected carriers [USWest]"(USWest Comments, p. 9); and 3) that the Commission should not involve itself in matters of local regulation. None of these arguments should prevent the Commission from granting the Petition.

A. McLeodUSA and other commenters have, indeed, set forth the necessary facts.

USWest maintains that McLeodUSA has not set forth sufficient facts to warrant relief. Yet McLeodUSA has set forth the one fact that is most relevant -- McLeodUSA and others have been prevented from competing in Nebraska because of USWest's withdrawal of Centrex service. This fact alone presents a *prima facie* case of a violation of section 253(a).

McLeodUSA states that it has not provided service in Nebraska because of USWest's withdrawal of service. McLeodUSA's statement is credible; McLeodUSA does, in fact, provide service in several states where Centrex is available. Further, both MCI and AT&T argued before the Nebraska PSC that they intended to engage in Centrex resale if it were made available to them. And the Joint Filers (FTI and ATI) both stated that the withdrawal of Centrex "substantially undermined" their ability to provide competitive local exchange service in Nebraska. According to the commenters, there is no Centrex resale competition in Nebraska. What other additional facts are necessary?⁴

USWest's statement that "McLeod has never used Centrex as a resale vehicle in Nebraska" (USWest Comments, p. 5) is disingenuous because USWest withdrew its Centrex offering before McLeodUSA received authority from the Nebraska PSC to provide service in Nebraska. It is circular at best for USWest to argue that

⁴ In fact, to the extent there is a lack of evidence of competition in Nebraska, this lack of evidence *supports* the argument that USWest's withdrawal of service has been anti-competitive.

withdrawal of Centrex has not impeded competition because McLeodUSA has not entered the market, when it is USWest's withdrawal of service itself that has caused McLeodUSA not to provide service. Clearly, USWest's withdrawal of Centrex has had the effect of prohibiting carriers from offering service in Nebraska

Once the competitors establish that the withdrawal of Centrex service has prevented competition in Nebraska, the burden should shift to USWest to justify its withdrawal of service. USWest has failed to provide any evidence to demonstrate why its withdrawal of service was necessary.

B. USWest's argument that the Commission cannot "expropriate" USWest's property is unfounded.

USWest's argument that the Commission cannot order USWest to provide service or risk "expropriating" USWest property is an old, tired argument against regulation generally. Incumbent local exchange carriers have, for years, maintained before state regulators that their rates for Centrex service were above cost. These carriers have also been subject to obligations to provide service as a "carrier-of-last-resort," sometimes even at below-cost rates. If courts have allowed regulators to require carriers to provide service at a loss, there is little danger that courts would prevent regulators from requiring carriers to provide Centrex service at rates that allow them to earn a profit.

C. Although the FCC should exercise caution concerning local telephone service offerings, the facts in this case warrant FCC action to require USWest to expand its provision of Centrex service to additional customers and resellers.

USWest maintains that granting the Petition would involve the Commission

in local ratemaking decisions that are traditionally within the province of state regulators. CPI shares USWest's concern on this point. As a general matter, CPI does not endorse policies which encourage the FCC to determine what local exchange services should or should not be provided. Any effort by the FCC to engage in these matters must be closely coordinated with state commissions and must rest upon a solid legal and policy foundation. The FCC should step lightly and with great caution concerning issues involving state and local services and rates.

In this case, however, the evidence demonstrates that USWest has acted in a manner that harms competitors and consumers alike. USWest has admitted that one reason for its withdrawal of Centrex service is to prevent resellers from engaging in "arbitrage." In other words, USWest does not argue that it failed to earn a profit off of its Centrex offerings; it argues only that withdrawing the Centrex service was necessary to prevent competitors from using the service.⁵

Furthermore, the issue in this case is not whether the FCC should order USWest to provide a new service, the issue is only whether USWest should be required to continue to provide an existing service to an expanded group of customers (beyond the "grandfathered" customers). While this issue certainly

⁵ USWest alludes a link between Centrex resale and universal service when it maintains that "resale of Centrex . . . has also become an arbitrage vehicle which was jeopardizing the stability of subsidized local residential rates." (USWest Comments, p.4) If there is any linkage between Centrex resale and residential rates, USWest has not provided any of this information to the Commission. Furthermore, the issue of universal service can be handled and is being handled separately by the FCC and states in their respective universal service programs. In fact, to the extent that Centrex resale drives Centrex prices closer to cost and forces universal service subsidies to be made explicit, Centrex resale fulfills the very purposes of the 1996 Act.

presents a close call, USWest's anticompetitive intentions and its current provision of the service, and the explicit and detrimental effect on competition that resulted from USWest's withdrawal of service, all support the FCC's exercise of its legal authority to require USWest to make Centrex service available to resellers and other customers.

D. The arguments raised by the Nebraska PSC are unpersuasive.

The arguments raised by the Nebraska PSC against the Petition are unpersuasive. The Nebraska PSC suggests that the FCC should not issue a ruling on the Petition because McLeodUSA's appeal of the case is currently pending before the Nebraska Supreme Court. While certainly of interest, the decision of the Nebraska Supreme Court concerning its interpretation of Nebraska *state* law does not determine how the FCC should rule as a matter of *federal* law. Neither section 251 nor section 253 depend upon a state court ruling before finding that a provision violates the Communications Act.

The Nebraska PSC further argues that McLeodUSA failed to make a convincing argument in its presentation to the PSC in a public hearing held on May 30, 1996. Again, that the PSC disagreed with McLeodUSA's position does not determine how the FCC should rule. State decisions are not dispositive under section 253; if they were, section 253 would have no meaning. The Communications Act specifically gives the FCC the authority to determine whether a state or local government has violated section 253.

The Nebraska PSC focuses on McLeod's argument that the PSC should have

denied the withdrawal of Centrex pursuant to PSC rule 002.21. The interpretation of that rule is not relevant to the analysis of sections 251 and 253. Again, even if the PSC correctly distinguished between a rate list change and a service withdrawal under Nebraska state law, the relevant question in this Petition is whether the PSC's action violated *federal* law.

IV. A LEGAL ANALYSIS SUPPORTS FCC ACTION TO REMEDY A VIOLATION OF THE COMMUNICATIONS ACT.

Section 253(a) states as follows:

No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.

The first question raised by this language is whether the Nebraska PSC's decision to give permission to USWest to withdraw Centrex service is a state "regulation" or "legal requirement". USWest implies that, because Nebraska law does not require approval of a service withdrawal, its withdrawal of service is not a regulation or requirement.⁶ The Nebraska PSC claims that USWest simply proposed changes to its "rate list", and the Nebraska PSC "lacks jurisdiction to deny a rate list change."⁷

CPI does not challenge these parties interpretation of Nebraska law.

However, the question raised by this Petition before the FCC is whether or not the Nebraska PSC's action constituted a state "regulation" or "legal requirement". By

⁶ USWest Comments, p. 5.

⁷ Nebraska PSC Comments, p. 3.

formally denying the complaint filed by McLeodUSA, MCI, and AT&T, and by ruling that USWest would be permitted to withdraw Centrex Service, the Nebraska PSC clearly engaged in the type of state action that is subject to section 253. In fact, that the PSC's Order directs USWest to offer service to resellers serving "grandfathered" customers demonstrates that the PSC has the jurisdiction to control the offering of the Centrex service.

The second issue is whether the Nebraska PSC's action prohibits or has the effect of prohibiting "any interstate or intrastate telecommunications service." USWest's primary argument is that McLeodUSA "offers no facts at all to sustain its contention that the Nebraska PSC's decision to permit USWest to withdraw the Centrex Plus product is anti-competitive." (USWest Comments, p. 7). As stated earlier, however, the evidence on this point is clear. McLeodUSA, FTI and ATI all state that they would have provided competitive local exchange service in Nebraska but for USWest's withdrawal of Centrex service.⁸

The facts in this case demonstrate a clear violation of section 253(a). The Commission must, therefore, take action to remedy this violation of the Communications Act. CPI recommends that the Commission take action, working

⁸ Nebraska PSC's attempt to distinguish between a "rate list" and a service offering is belied by the PSC's own order and USWest's comments. The PSC's Order directs USWest "to make Centrex Plus *service* available to certificated resellers of local *service* . . . (PSC Order, p. 6) Further, USWest admits that Centrex Plus is a service ("Centrex Plus is a normal local exchange *service*.") (USWest Comments, p. 4) The Nebraska PSC's decision approving the withdrawal of Centrex service thus clearly falls within the ambit of section 253, which forbids actions that prohibit or have the effect prohibiting an interstate or intrastate telecommunications *service*.

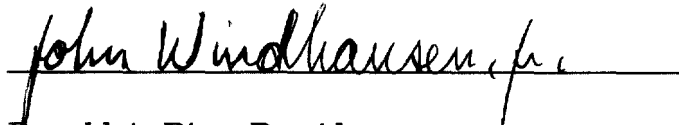
with the Nebraska PSC to the extent possible, to determine how they can ensure that USWest broadens its provision of Centrex service to additional customers and competitors.

V. CONCLUSION

McLeodUSA and the various commenters present a straightforward case that USWest's withdrawal of Centrex service has thwarted competition, harmed consumers and violated subsection 253(a) of the Communications Act. The withdrawal of Centrex service to all but existing customers has essentially prohibited these carriers from providing competing local telephone service in Nebraska. USWest's actions are particularly suspect here, as it appears that USWest withdrew its Centrex service offering intentionally to prevent the growth of competition by Centrex resellers. While USWest has withdrawn its Centrex service for new customers, it continues to make the service available to its "grandfathered" customers.

For all these reasons, the FCC must take action to remedy this violation of the Communications Act. CPI recommends that the Commission find a way, working with the Nebraska PSC to the extent possible, to ensure that USWest makes its Centrex service available to additional customers and competitors in Nebraska.

Respectfully Submitted,

A handwritten signature in cursive script, reading "John Windhausen, Jr.", is written over a horizontal line.

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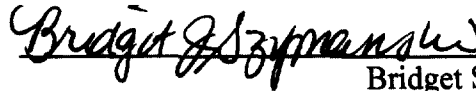
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Certificate of Service

I, Bridget J. Szymanski, hereby certify that on this twenty-seventh day of July, 1998, copies of the foregoing Reply Comments of the Competition Policy Institute were served by first-class, United States mail, postage prepaid, upon each of the following:



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